

Issue Paper Number 99-020



BOARD OF EQUALIZATION
KEY AGENCY ISSUE

- ☐ Board Meeting
- ☒ Business Taxes Committee
- ☐ Customer Services Committee
- ☐ Legislative Committee
- ☐ Property Tax Committee
- ☐ Technology & Administration Committee
- ☐ Other

REGULATION 1703, INTEREST AND PENALTIES

APPLICATION OF CREDIT INTEREST TO TAX OVERPAYMENTS

I. Issue

Under current statutes, credit interest is not allowed if taxpayer overpayments are a result of carelessness or intentional overpayment. The term carelessness is subjective and is not defined in the regulation. In order to promote consistent application of credit interest, should the Board amend Regulation 1703 to clarify the circumstances under which credit interest on overpayments is disallowable under Sales and Use Tax Law section 6908(a) related to carelessness by taxpayers?

II. Staff Recommendation

Staff recommends that Regulation 1703 be amended to facilitate a uniform application of credit interest, with an operative date of January 1, 2000, with respect to reporting periods beginning that date. Similar regulatory language should be adopted with regard to other Board tax and fee programs. Staff also recommends that the Sales and Use Tax Field Audit Manual (FAM) be amended to reflect the new regulatory language for determining when carelessness precludes allowance of credit interest on an overpayment.

III. Other Alternative(s) Considered

An alternative would be to sponsor legislation to amend section 6908(a) and other applicable sections in other Board tax and fee programs, and amend Regulation 1703 to replace "carelessness" with "negligence." Negligence would then have a statutory and a regulatory reference and be used as the standard for the denial of credit interest in taxpayer overpayments. Credit interest would normally be recommended in most overpayment situations except when the overpayment is due to taxpayer negligence, intentional overpayment, or situations statutorily excluded from receiving credit interest. In addition, the FAM would be amended to reflect the new guidelines for applying credit interest in refund processing.

IV. Background

Sales and Use Tax Law section 6908(a) and Regulation 1703(b)(5)(B) provide that:

“If the board determines that any overpayment has been made intentionally or by reason of carelessness, it shall not allow any interest thereon.”

The inclusion of the term “carelessness” in the statute dates back to its introduction in section 23, Overpayments; Refunds, in the 1939 version of the Retail Sales Tax Act. The 1937 version of section 23 included the language “interest shall be allowed and paid upon any overpayment of any tax, if the overpayment was not made because of an error or mistake on the part of the retailer.” Staff believes that the language was changed from “error or mistake” to “carelessness” because the earlier language may have been viewed as being too restrictive in the application of credit interest on overpayments.

Maintaining consistency in the application of denials of credit interest is difficult because of the subjective nature of the term “carelessness.”

Procedures for the disallowance of credit interest on refunds, other than those verified by audit, were provided in Business Taxes General Bulletin 61-12, effective May 1, 1961 (see Exhibit 1). This bulletin discussed the application of credit interest on overpayments and reporting errors processed by headquarters sections and district offices. The bulletin provides for a presumption of carelessness, with denial of credit interest, for the following reporting errors resulting in a tax overpayment:

1. Inclusion of receipts for periods other than that for which a return is intended.
2. Omission of allowable deductions.
3. Use of incorrect tax rate.
4. Errors of addition or subtraction.

The bulletin further provides that if district offices verify such overpayments by any means short of a regular audit, the refund recommendation will be transmitted to headquarters on a Form BT-414-B, Field Billing Order, and no credit interest will be included. If, however, the overpayment was caused by a misinterpretation of the law, from erroneous information furnished the taxpayer by Board staff or for any other “good” reason, a statement of such evidence should be included on the Field Billing Order and this would overcome the presumption of carelessness. In many instances, the Board may have allowed credit interest on refund claims verified in the districts, but denied credit interest on refund claims verified by headquarters sections.

In an attempt to establish a uniform application of credit interest, the Sales and Use Tax Department issued a memorandum dated November 15, 1991, to the District Administrators, that provided additional information regarding credit interest comments on audits and Field Billing Orders (see Exhibit 2). The purpose of this memo was to clarify that

carelessness was not to be equated with negligence in determining whether to recommend credit interest.

A January 1992 report by the Audit Evaluation and Planning Section noted that, of the 2,800 monthly refund documents processed by headquarters sections, fewer than five percent included credit interest (see Exhibit 3). When credit interest was allowed, it commonly involved overpayments caused by Board staff providing incorrect or misleading advice or other errors in which the Board was at least partly responsible.

The report also summarized the results of a limited review of district audits containing clerical errors made by the taxpayer that resulted in overpayments. The limited review disclosed that in more than 75 percent of the cases, the district allowed credit interest or offset a tax liability with overpayments within the same period, which provided credit interest at the debit interest rate.

Further complicating the issue of credit interest is the difference between the rate of interest on underpayments versus overpayments. In order to address a budget shortfall, the legislature adopted SB 180, which became effective July 15, 1991. In addition to a number of other revenue enhancing changes, this bill amended section 6591.5 by setting a different benchmark rate for interest paid by the Board on overpayments of tax (i.e., credit interest rate) than the rate paid by taxpayers on underpayments of tax (i.e., debit interest rate). The two interest rates are modified semiannually. Since July 1991, the credit interest rate has fluctuated between three and six percent while the debit interest rate has run between ten and fourteen percent. Currently the credit interest rate is four percent and the debit interest rate is ten percent.

Discussion of Issue:

The divergence in allowing credit interest between headquarters sections and the district offices appears to be based on differing interpretations of "carelessness." Many district offices have apparently equated carelessness with the higher standard of negligence when determining whether credit interest on overpayments should be allowed. This created a situation where a clerical error would be considered careless by headquarters sections and no credit interest would be allowed, while the same error would not be considered careless by district offices and credit interest would normally be granted, unless the cause for the error was considered to have resulted from taxpayer negligence.

FAM section 0504.10 states, "Negligence may be defined in general as a failure to exercise due care. In most cases the law has fixed no standard of care other than the general one that it must be such as a reasonably prudent man would exercise under similar circumstances. With respect to business tax matters, it may be further defined as a substantial breach by the taxpayer of some duty imposed by the law or authorized rules and regulations." Negligence may also be defined as extreme carelessness; therefore, relatively minor errors or mistakes do not equate to negligence.

Current Headquarters Practice

Consistent with section 6908(a), credit interest is not granted for overpayments resulting from carelessness. In processing refunds involving overpayments, the headquarters sections rely on the guidelines of Business Taxes General Bulletin 61-12 and FAM section 0217.18, revised in September 1996. These references outline most of the refund situations encountered by headquarters and result in the presumption of carelessness for any of the following reasons:

- Inclusion of receipts for periods other than that for which the return is intended.
- Omission of allowable deductions.
- Use of incorrect tax rate.
- Errors of addition or subtraction.

As a result, most refunds involving the above four types of errors are processed by headquarters sections without allowing credit interest. In addition, claims for refund involving repetitive errors on similar transactions have historically been denied credit interest.

Current District Practice

In verifying refund claims, the district offices usually recommend credit interest on net credit audits except in cases of intentional overpayments, or where either a negligence or fraud penalty is assessed or would have been assessed if the net results had been a deficiency. In recommending credit interest involving taxpayer overpayments, district offices refer to FAM section 0217.12 which provides:

“When the overpayment is not made intentionally but the circumstances are such that a 10% penalty for negligence would be warranted had the audit resulted in a net deficiency, no credit interest is allowable. Interest on overpayments made intentionally or by reason of carelessness can be disallowed without the application of the negligence penalty.”

A standard comment is usually included in net credit situations such as: “the taxpayer was making a conscientious effort to report tax properly.” This type of comment, although subjective on the part of the auditor, overcomes the presumption of carelessness that would normally apply to reporting errors.

In situations involving net tax overpayments in consecutive audits, where such errors occurred on the same or similar types of transactions disclosed in the prior audit, credit interest is generally not recommended.

One interested party letter was received regarding this issue paper. The interested party's comments addressed two specific concerns: (1) the Board should allow credit on most

overpayments, since one party has the use of the other party's funds and, (2) the Board should change the timing of when overpayments are allowed to offset underpayments in an assessment, where credit interest is not allowed.

With regard to the interested party's first concern, both the Board and industry agree that credit interest should be allowed on most overpayments. The recommended amendment to Regulation 1703 will establish a uniform application of credit interest to overpayments. The interested party's second concern was not an issue addressed by this issue paper; however, it is currently a matter under review by Board staff.

Additionally, the interested party recommended that the Board propose legislation to remove the statutory reference to "carelessness" from Sales and Use Tax Law section 6908(a) as a basis for denial of credit interest. Staff determined that an amendment to Regulation 1703 could accomplish industry objectives in a more expeditious manner.

V. Staff Recommendation

A. Description of the Staff Recommendation

Staff recommends that Regulation 1703(b)(5)(B) be amended to facilitate a uniform application of credit interest, with an operative date of January 1, 2000, with respect to reporting periods beginning that date. Similar regulatory language should be proposed with regard to other Board tax and fee programs. Staff also recommends that the Sales and Use Tax Field Audit Manual (FAM) be amended to reflect the new regulatory language for determining when carelessness precludes allowance of credit interest on an overpayment.

Under the proposed regulatory language, credit interest would be disallowed in the following situations:

- The taxpayer knowingly overpays their tax liability.
- The taxpayer makes recurring overpayments due to clerical or computational errors on the face of the tax return or on supporting schedules submitted with the tax return and the taxpayer has been notified by the Board in writing of such errors. Examples of such errors are inclusion of receipts for periods other than that for which the return is intended; omission of allowable deductions; use of incorrect tax rate; and addition or subtraction errors.
- Audits in which it is determined the taxpayer has overpaid their tax liability, and where a negligence penalty would have been assessed had the audit resulted in a net deficiency.
- Audits with credit periods where a negligence or fraud penalty is assessed.

- There are tax overpayments caused by repeated errors in similar transactions when the taxpayer has been notified by the Board in writing, including comments in audit workpapers, that such transactions are either non-taxable or are tax exempt.
- The reallocation of excess prepayments to subsequent periods when a claim for refund is not involved. This occurs when a taxpayer has made an excess or duplicate prepayment and directs the Return Analysis Section to apply the excess tax credit as a prepayment in a subsequent reporting period.
- Credit interest is not allowable on refunds by terms of the statute.

B. Pros of Staff Recommendation

- Does not require legislative change, thereby expediting enactment of proposal.
- Aligns the application of credit interest in district offices and headquarters.
- Perceived as a more equitable approach than the current procedures by taxpayers who would not otherwise receive credit interest on their claims for refund.

C. Cons of Staff Recommendation

- May increase administrative burden to determine whether to grant credit interest if some taxpayers attempt to overpay their taxes and use the Board as a “bank” when the rate for credit interest exceeds bank interest rates. If pending legislation, such as AB 1208, is enacted to equalize the credit interest rate with the debit interest rate, this change could further increase the attractiveness of overpaying tax in order to take advantage of an attractive yield, creating a substantial revenue loss to the Board.

D. Statutory or Regulatory Change

- Requires a regulatory change.

E. Administrative Impact

- Depending on the rate of credit interest paid, this proposal may increase administrative burden to determine whether to grant credit interest if some taxpayers attempt to overpay their taxes to obtain a higher rate of interest than bank rates.

F. Fiscal Impact

- Cost Impact – considered to be absorbable.

- Revenue Impact – The proposed regulatory language would result in credit interest being allowed in more situations than is the case with the current interpretation of what constitutes carelessness. The annual revenue reduction is estimated to be \$4.9 million (see Exhibit 4).

G. Taxpayer/Customer Impact

- Taxpayers are more likely to receive credit interest on overpayments under the proposed regulatory language.

H. Critical Time Frames

- There are no critical time frames.

VI. Alternative 1

A. Description of Alternative 1

Sponsor legislation to amend section 6908(a) and other applicable sections for other Board tax and fee programs, and amend Regulation 1703, to replace “carelessness” with “negligence.” Negligence would then be used as the standard for denial of credit interest for taxpayer overpayments. Credit interest would be recommended on most overpayments, except in cases of intentional overpayment, recurring overpayments caused by clerical or computational errors when the taxpayer has been notified by the Board in writing of such errors, negligence, fraud, or situations statutorily excluded from receiving credit interest. In addition, the FAM would be amended to reflect the new guidelines for applying credit interest in refund processing.

B. Pros of Alternative 1

- Aligns the application of credit interest in district offices and headquarters.
- Perceived as a more equitable approach than the current procedures by taxpayers who would not otherwise receive credit interest on their claims for refund.
- Uses the better-defined term of negligence instead of carelessness as the basis for denial of credit interest.

C. Cons of Alternative 1

- Requires a legislative change to be enacted.
- Time delay in enactment of the statutory change.
- May increase administrative burden to determine whether to grant interest if some taxpayers attempt to overpay their taxes and use the Board as a “bank” when the rate for credit interest exceeds bank interest rates. If pending

legislation, such as AB 1208, is enacted to equalize the credit interest rate with the debit interest rate, this change could further increase the attractiveness of overpaying tax in order to take advantage of an attractive yield, creating a substantial revenue loss to the Board.

D. Statutory or Regulatory Change

- Requires both a statutory and regulatory change. In addition, for conformity, the following sections should be changed to replace the reference to carelessness with negligence.

Section	Tax or Fee Program
8131	Motor Vehicle Fuel
9156	Use Fuel Tax
60525	Diesel Fuel Tax
32406	Alcoholic Beverage Tax
30367	Cigarette and Tobacco Products Tax
40117	Energy Resources Surcharge
41106	Emergency Telephone User's Surcharge
43456	Hazardous Substances Tax
45656	Integrated Waste Management Fee
50142.2	Underground Storage Tank Maintenance Fee
55226	Tire Recycling Fee, Fee Collection Procedures Law
46507	Oil Spill Response, Prevention and Administration Fee

E. Administrative Impact

- Depending on the rate of credit interest paid, this proposal may increase administrative burden to determine whether to grant credit interest if some taxpayers attempt to overpay their taxes to obtain a higher rate of interest than bank rates.

F. Fiscal Impact

- Cost Impact – Considered to be absorbable.
- Revenue Impact – Would result in credit interest being allowed in more situations than is the case with the current interpretation of what constitutes carelessness. The annual revenue reduction is estimated to be \$4.9 million (see Exhibit 4).

G. Taxpayer/Customer Impact

- Taxpayers are more likely to receive credit interest on overpayments under this alternative.

H. Critical Time Frames

- There are no critical time frames

Prepared by: Sales and Use Tax Department
Program Planning Division

Current as of: July 15, 1999
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STATE BOARD OF EQUALIZATION
OFFICE CORRESPONDENCE

Place: Sacramento, California

Date: April 27, 1961

Headquarters and Field Staff,

To: Department of Business Taxes

From: H. A. Dickson

Re: Disallowance of Interest on Sales and Use Tax
Refunds Other Than Those Verified by Audits

EFFECTIVE - MAY 1, 1961

1. Many overpayments are disclosed by Headquarters' review of tax returns. Others are brought to our attention by taxpayers either by letter or by calling at field offices of the Board.
2. Typical reporting errors resulting in tax overpayments are:
 - a. Inclusion of receipts for periods, other than that for which a return is intended.
 - b. Omission of allowable deductions.
 - c. Use of incorrect tax rate.
 - d. Errors of addition or subtraction.
3. In processing a refund resulting from review of a tax return or from a claim received from a taxpayer where the overpayment arises from an isolated transaction or from causes such as those illustrated in the preceding Paragraph 2, and where no field audit is involved, it will be presumed that the overpayment was due to carelessness and no interest will be allowed. (Section 6908 of the Sales and Use Tax Law.)
4. When, a tax overpayment is verified by a district staff member by any means short of a regular audit, the refund recommendation will be transmitted to Headquarters by use of Form 414-B, Field Billing Order. Interest computations shall not be included.
5. If, in the course of verifying a tax overpayment, evidence is found that the overpayment occurred because of a misinterpretation of the law, from erroneous information furnished the taxpayer by the Board's staff or for other good

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reasons, a statement of such evidence which may overcome the presumption of carelessness should be written on the lower portion of the face of Form 414-B under the caption "Interest". Headquarters' reviewers then will determine whether interest is to be allowed on the overpayment.

6. What is said in this bulletin does not affect or modify instructions found in Section 2.178 of the Audit Manual regarding interest on overpayments verified by regular field audits. There is no change in existing procedures for treatment of tax credits by audit reports.

Principal Tax Auditor

Approved:

Harry L. Say
Assistant Secretary
Business Taxes

DISTRIBUTION 7-C

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State of California

M e m o r a n d u m

To : District Administrators**Date:** November 15, 1991**From** : Glenn A. Bystrom
Principal Tax Auditor**Subject** : Credit Interest Comment

It appears that additional guidance is needed to insure that the policy of granting interest on overpayments is applied uniformly throughout the state. As you know, Section 0217.12 of the Audit manual briefly discusses the circumstances under which credit interest is allowable; however, no comment is currently required on a Report of Field Audit (BT-414-A) when it is allowed. However, a "Credit Interest" comment is required by Section 0217.18 when recommending credit interest be granted on a Field Billing Order (BT-414-B). Currently, the auditor makes a recommendation to the Headquarters Audit Review and Refund Section if they determine that credit interest should be granted on a FBO.

To ensure uniformity in the application of credit interest on both audits and FBO's, the following guidance will be effective with audits and FBO's submitted by the auditor after November 15, 1991:

1. The "Overpayment" comment as called for by AM Section 216.03 will continue to be made on the BT-414-A for refund audits. A comment is not necessary for credit captions or periods in a deficiency audit.
2. A separate "Credit Interest" comment will be made on all BT-414-A's and B's if credit interest is being allowed in one or more quarters. No comment is required if credit interest is not allowed.
3. The auditor will compute the interest in accordance with their recommendations on both BT-414-A's and B's using the AUINT program. If Headquarters' Audit Review and Refunds Section does not concur, they will recompute the interest.

The auditor should carefully consider the circumstances in each case before allowing credit interest. The law provides that no interest is allowable on overpayments made intentionally or by reason of carelessness. Carelessness is not to be equated with negligence. One definition of negligence is "extreme carelessness;" therefore, relatively minor errors can and should

District Administrators

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November 15, 1991

be considered in determining whether credit interest will be allowed. The factors listed in Section 0217.18 should be considered in determining carelessness including the evaluation of each credit quarter separately if appropriate.

The above guidance will be incorporated into the Audit Manual in the next revision to Chapter 2.

GAB:ama
B-A52

cc:
Mr. Robert Nunes
Mr. Charles Cordell
Mr. William D. Dunn
Audit Review and Refunds
Audit Evaluation and Planning
Headquarters Audit Supervisors

Please incorporate this change
into the audit manual.

Mr. Glenn A. Bystrom
Principal Tax Auditor

January 29, 1992

Ramon J. Hirsig, Supervisor
Audit Evaluation and Planning

Uniform Application of Credit Interest

As requested, the issue of credit interest has been reviewed at the district and headquarter's level. While it is clear that the headquarter's sections are more inclined to deny credit interest as compared to the districts, I am not certain this can be construed as a problem. The question of allowing credit interest is purely a judgment call on the part of the individual reviewing the transaction. Many times this call can be influenced by the amount of exposure to a taxpayer's situation. Normally, the field staff will have more exposure to the taxpayer's situation since they generally review the taxpayer's records and operation for a three year period. On the other hand, the headquarter's staff will have a different perspective since they generally have limited contact with the taxpayer (written correspondence) and focus only on one specific transaction or group of transactions.

As such, the field staff's evaluation helps disclose the reasons why the overpayment was made and helps in determining whether or not to grant credit interest. The headquarter's staff does not have this luxury and must make the decision based primarily on written correspondence with little exposure to the taxpayer's actual operation. In most cases, this limited review results in the denial of credit interest.

Headquarter's sections preparing refund documents include Audit Review and Refund, Return Review, Collections, and Consumer Use Tax. The Headquarter's staff generates approximately 2,800 refund documents monthly and fewer than five percent of these refunds will include credit interest. When credit interest is allowed, it commonly involves overpayments caused by the board's misadvice or other errors in which the board is at least partly responsible. A significant portion of refunds cleared in headquarters involve clerical errors in preparing returns and such errors are generally construed as careless thereby resulting in credit interest being denied. Occasionally, there are cases that headquarter's staff recommends denial of credit interest but later allows credit interest after the taxpayer calls to explain the problem more clearly and requests credit interest.

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Unfortunately, without a complete review of the taxpayer's operation as is performed by the district staff during an audit, it is difficult for the headquarters's staff to forego the thought of carelessness and recommend credit interest.

A brief test of district audits containing clerical errors resulting in taxpayer overpayment disclosed that in more than 75 percent of the cases, the district allowed credit interest or offset the credit tax amounts with debit tax amounts in the same period thereby allowing credit interest. In fact, with the recent change in the calculation of interest, tax offsets in the same period would not only allow the taxpayer credit interest on overpayments but at the higher debit interest rate.

Additionally, there are also differences in the decision to grant credit interest among the districts. One difference among the districts involves their interpretation of the law as it applies to denying credit interest on overpayments. Many of the district offices have incorrectly construed that carelessness is equated with negligence when determining whether credit interest should be allowed. However, with the distribution of your November 15, 1991 memorandum to District Administrators clearly differentiating carelessness from negligence, I feel this gap among districts as well as between field and headquarter's staff will be narrowed.

If you wish to further narrow the gap, I recommend that we mandate how credit interest applies to specific situations. For example, refunds involving a taxpayer receiving a late issuance of a resale certificate generally results in the field staff recommending credit interest and headquarter's staff recommending no credit interest. We could approach this scenario with the idea that the taxpayer is normally not careless in these cases and credit interest should be allowed whether it be reviewed in the district or headquarters. Another example may include cases in which excess tax reimbursement has been collected by a taxpayer and remitted to the state for which a taxpayer is now requesting a refund. Normally, headquarter's staff will not recommend credit interest but the district staff is more inclined to grant the credit interest. Since the law mandates that the taxpayer must only refund to its customers the excess tax collected from its customers, granting credit interest would unjustly enrich the taxpayer as he/she had utilized their customer's money and is not required under the law to refund the credit interest. In addition, we could also mandate that any overpayments resulting from the Board's incorrect guidance should be refunded with credit interest.

After reviewing the situation, it appears that no matter how many controls we place on the granting and denial of credit interest, there will continue to be differences between refunds completed by the field and the headquarter's staff. The decision to grant or deny credit interest is

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subjective and as such I feel it would be inappropriate for us to mandate when credit interest should apply to any particular situation. I believe your memo of November 15, 1991 regarding credit interest should narrow the gap on credit interest decisions not only among districts but also between the field and headquarter's staff.

If you have any questions regarding this matter, please let me know.

RJH:jmh
gm1230



REGULATION 1703, INTEREST AND PENALTIES APPLICATION OF CREDIT INTEREST TO TAX OVERPAYMENTS

Staff Recommendation

Amend Regulation 1703, Interest and Penalties to facilitate a more uniform application of credit interest.

Background, Methodology, and Assumptions

Board guidelines currently provide for payment of credit interest on overpayments of tax when it is determined that the overpayment has not been made intentionally or by reason of carelessness. Credit interest is granted, for example, in cases where a taxpayer reported tax on a transaction that, through a change in interpretation of law, has been deemed exempt, i.e., wine barrels. Credit interest is generally not allowable under current guidelines for errors in reporting that are deemed caused by carelessness, such as:

1. Inclusion of receipts for periods other than that for which a return is intended.
2. Omission of allowable deductions.
3. Use of incorrect tax rate.
4. Errors of addition or subtraction.

The Sales and Use Tax Department and the Special Taxes Department did a study in which they examined the reasons that credit interest was denied on tax overpayments. They determined that credit interest of \$4.9 million annually due to taxpayer errors was not granted.

The staff recommendation would amend Regulation 1703 to broaden and clarify the circumstances in which credit interest involving taxpayer errors is allowed.

Revenue Summary

The annual increased credit interest payments that would be made by amending Board guidelines to expand the circumstances under which such interest would be allowed is estimated to be \$4.9 million.

Qualifying Remarks

The alternative proposal is to sponsor legislation to amend Revenue and Taxation Code Section 6908(a) and Regulation 1703 to replace “carelessness” with “negligence” as the basis for denial of credit interest on tax overpayments. The revenue impact of that proposal would be the same as the revenue impact for the staff recommendation. Increased credit interest payments would amount to \$4.9 million annually. However, since the legislation will probably be prospective only, there would be no equity claims.

If pending legislation is enacted to equalize the credit interest rate, currently 4 percent, with the debit rate, currently 10 percent, the credit interest payments granted by this proposal would be increased substantially.

Preparation

This revenue estimate was prepared by David E. Hayes, Statistics Section, Agency Planning and Research Division. This revenue estimate was reviewed by Ms. Laurie Frost, Chief, Agency Planning and Research Division and Ms. Freda Orendt-Evans, Program Planning Manager, Sales and Use Tax Department. For additional information, please contact Mr. Hayes at (916) 445-0840.

Current as of July 13, 1999

Regulation 1703, Interest and Penalties
Comparison of Current Language and Staff and Industry Proposed Language
As of July 13, 1999

Exhibit 5

Action Item	Current Regulatory Language	Staff and Industry's Proposed Regulatory Language	Summary Comments
ACTION 1 - CONSENT	<p>Regulation 1703. Interest And Penalties.</p> <p>(b) Interest.</p> <p>(5) Refunds and Credits.</p> <p>(B) Intentional or Careless Overpayments. If the board determines that any overpayment has been made intentionally or by reason of carelessness, it shall not allow any interest thereon.</p>	<p>Regulation 1703. Interest And Penalties.</p> <p>(b) Interest.</p> <p>(5) Refunds and Credits.</p> <p>(B) Intentional or Careless Overpayments. If the board determines that any overpayment has been made intentionally or by reason of carelessness, it shall not allow any interest thereon.</p> <p><u>Operative January 1, 2000, with respect to reporting periods beginning on that date, credit interest will be allowed on all overpayments, except when statutorily prohibited or in cases of intentional overpayment, fraud, negligence, or carelessness. Carelessness occurs if a taxpayer makes an overpayment which: 1) is the result of a computational error on the return or on its supporting schedules or the result of a clerical error such as including receipts for periods other than that for which the return is intended, failing to take allowable deductions, or using an incorrect tax rate; and 2) is made after the taxpayer has been notified in writing by the Board of the same or similar errors on one or more previous returns.</u></p>	<p>Staff and industry agree that credit interest should be paid on most overpayments. Industry contends that the policy behind providing interest, both on overpayments and underpayments, is that one party has use of the funds belonging to another party.</p> <p>Staff's opinion is that credit interest should be allowed in all situations except for those cited in the proposed regulatory language.</p>

Regulation 1703, Interest and Penalties
Comparison of Current Language and Staff and Industry Proposed Language
As of July 13, 1999

Exhibit 5

Action Item	Current Regulatory Language	Staff and Industry's Proposed Regulatory Language	Summary Comments
ACTION 1 - CONSENT	<p>Regulation 1703. Interest And Penalties.</p> <p>(b) Interest.</p> <p>(5) Refunds and Credits.</p> <p>(B) Intentional or Careless Overpayments. If the board determines that any overpayment has been made intentionally or by reason of carelessness, it shall not allow any interest thereon.</p>	<p>Regulation 1703. Interest And Penalties.</p> <p>(b) Interest.</p> <p>(5) Refunds and Credits.</p> <p>(B) Intentional or Careless Overpayments. If the board determines that any overpayment has been made intentionally or by reason of carelessness, it shall not allow any interest thereon.</p> <p><u>Operative January 1, 2000, with respect to reporting periods beginning on that date, credit interest will be allowed on all overpayments, except when statutorily prohibited or in cases of intentional overpayment, fraud, negligence, or carelessness. Carelessness occurs if a taxpayer makes an overpayment which: 1) is the result of a computational error on the return or on its supporting schedules or the result of a clerical error such as including receipts for periods other than that for which the return is intended, failing to take allowable deductions, or using an incorrect tax rate; and 2) is made after the taxpayer has been notified in writing by the Board of the same or similar errors on one or more previous returns.</u></p>	<p>Staff and industry agree that credit interest should be paid on most overpayments. Industry contends that the policy behind providing interest, both on overpayments and underpayments, is that one party has use of the funds belonging to another party.</p> <p>Staff's opinion is that credit interest should be allowed in all situations except for those cited in the proposed regulatory language.</p>

Regulation 1703. Interest And Penalties.

References: Revenue and Taxation Code Sections listed below in paragraph (a).

(a) Statutory Provisions. Interest and penalties are prescribed in various sections of the Sales and Use Tax Law as follows:

<i>Subject</i>	<i>Sections</i>	
	<i>Interest</i>	<i>Penalties</i>
Failure to pay tax within required time (except determinations)	6480.4, 6480.8 6480.19, 6591	6476, 6477, 6478, 6479.3 6480.4, 6480.8, 6480.19, 6591, 7051.2
Failure to file a timely return		6479.3, 6591
Deficiency determinations	6482	6484 (negligence) 6485 (fraud) 7051.2
Determination - failure to make return	6513	6511, 7051.2 6514 (fraud)
Jeopardy determinations	6537	6537, 7051.2
Extensions of time	6459	
Determinations - Nonpayment of		6565, 7051.2
Offsets	6512	6512
Refunds and credits	6901, 6907 6908	6901
Suits for refund	6936	
Disposition of interest and penalties	7101	7101
Criminal Penalties		6073, 6094.5, 6422.1, 7152, 7153, 7153.5
Failure to make timely application for registration of motor vehicle, mobilehome, aircraft or undocumented vessel	6291-6294	6291-6294

<i>Subject</i>	<i>Interest</i>	<i>Sections</i> <i>Penalties</i>
Registration of vehicle, vessel or aircraft out of state		6485.1, 6514.1 (intent to evade)
Advertising that use tax will be absorbed		6207
Any violation of Sales and Use Tax Law		7153, 7153.5
Failure to collect use tax		6207
Failure to display use tax separately		6207
Failure to furnish return or other data		6452, 6455
Improper use of resale certificates	6072	6072, 6094.5
Making false return		7152
Misuse of vehicle use tax exemption certificates		6422.1
Operating as seller without permit		6071, 6077
Failure to obtain valid permit		6077, 7155
Relief from interest or penalty	6593, 6596	6592, 6596
Modified adjusted rate	6591.5	
Failure to obtain evidence that operator of catering truck holds valid permit		6074
Improper allocation of local tax by direct payment permit holder		7051.2
Managed Audit Program	7076.5	
Failure to pay tax due to an error or delay by an employee of the Board or Department of Motor Vehicles	6593.5	
Erroneous refund	6964	

(b) Interest.

(1) Interest Rates.

(A) In General. Interest is computed at the modified adjusted rate per month, or fraction thereof. “Modified adjusted rate per month, or fraction thereof” means the modified adjusted rate per annum divided by 12.

(B) Underpayments. “Modified adjusted rate per annum” for underpayments of tax is the rate for underpayments determined in accordance with the provisions of Section 6621 of the Internal Revenue Code plus three percentage points. Such rate is subject to semiannual modification pursuant to the provisions of subparagraph (c) of Section 6591.5 of the Revenue and Taxation Code.

(C) Overpayments. Except as provided below, “modified adjusted rate per annum” for overpayments of tax is the bond equivalent rate of 13-week treasury bills auctioned, rounded to the nearest full percent (or to the next highest full percent if .50%), subject to semiannual modification pursuant to the provisions of subparagraph (d) of Section 6591.5 of the Revenue and Taxation Code. For the period July 1, 1991, through June 30, 1992, the modified adjusted rate per annum for overpayments is equal to the bond equivalent rate of 13-week treasury bills auctioned on July 1, 1991, rounded to the nearest full percent (or to the next highest full percent if .50%).

(D) Managed Audit Program. Upon completion of the managed audit and verification by the board, interest shall be computed at one-half the rate that would otherwise be imposed for liabilities covered by the audit period.

(E) Error or Delay by Employee of Board or Department of Motor Vehicles. For tax liabilities that arise during taxable periods commencing on or after July 1, 1999, the Board, in its discretion, may relieve all or any part of the interest imposed on a person by Sections 6480.4, 6480.8, 6513, 6591, and 6592.5 of the Revenue and Taxation Code under either of the following circumstances:

1. Where the failure to pay tax is due in whole or in part to an unreasonable error or delay by an employee of the Board acting in his or her official capacity.

2. Where failure to pay use tax on a vehicle or vessel registered with the Department of Motor Vehicles was the direct result of an error by the Department of Motor Vehicles in calculating the use tax.

For the purposes of this subdivision, an error or delay shall be deemed to have occurred only if no significant aspect of the error or delay is attributable to an act of, or a failure to act by, the taxpayer.

Any person seeking relief under this subdivision shall file with the Board a statement under penalty of perjury setting forth the facts on which the claim for relief is based and any other information which the Board may require.

(F) Erroneous Refund. Operative for any action for recovery under Revenue and Taxation Code section 6961 on or after July 1, 1999, no interest shall be imposed on the amount of an erroneous refund by the Board until 30 days after the date on which the Board mails a notice of determination for repayment of the erroneous refund if the Board finds that neither the person liable for payment of tax nor any party related to that person had in any way caused an erroneous refund for which an action for recovery is provided under Section 6961 of the Revenue and Taxation Code. The act of filing a claim for refund shall not be considered as causing the erroneous refund.

(2) Late Payments Generally. Interest applies to the amount of all taxes, except prepayments of amounts of tax due and payable pursuant to Section 6471 of the Revenue and Taxation Code, not paid within the time required by law from the date on which the amount of tax became due and payable until the date of payment.

Interest applies to amounts due but not paid by any distributor or broker of motor vehicle fuel who fails to make a timely remittance of the prepayment of tax required pursuant to Sections 6480.1 and 6480.3 of the Revenue and Taxation Code.

Operative January 1, 1992, interest applies to amounts due but not paid by any producer, importer, or jobber of fuel as defined in Section 6480.10 of the Revenue and Taxation Code who fails to make a timely remittance of the prepayment of tax required pursuant to Sections 6480.16 and 6480.18 of the Revenue and Taxation Code.

(3) Determinations. Except as otherwise provided in subdivisions (b)(1)(E) and (b)(1)(F) above, interest applies to all determinations from the date on which the amount of tax becomes due and payable until the date of payment.

(4) Extensions of Time. In cases in which an extension of time for the filing of a return and the payment of tax has been granted, interest applies from the date on which the tax would have been due and payable had the extension not been granted until the date of payment. In cases in which an extension of time has been granted for making a prepayment of tax pursuant to Section 6471 of the Revenue and Taxation Code, interest applies to the unpaid amount of the required prepayment at the same rate.

(5) Refunds and Credits.

(A) In General. If an overpayment is credited on amounts due from any person or is refunded, interest will be computed on the overpayment from the first day of the calendar month following the month during which the overpayment was made. A refund or credit shall be made of any interest imposed upon the person making the overpayment with respect to the amount being refunded or credited. Interest will be paid in the case of a refund, to the last day of the calendar month following the date upon which the person making the overpayment, if he or she has not already filed a claim, is notified by the board that a claim may be filed or the date upon which the refund is approved by the board, whichever date is the earlier; and in the case of a credit, to the same date as that to which interest is computed on the tax or amount against which the credit is applied.

(B) Intentional or Careless Overpayments. ~~If the board determines that any overpayment has been made intentionally or by reason of carelessness, it shall not allow any interest thereon.~~
Operative January 1, 2000, with respect to reporting periods beginning on that date, credit interest will be allowed on all overpayments, except when statutorily prohibited or in cases of intentional overpayment, fraud, negligence, or carelessness. Carelessness occurs if a taxpayer makes an overpayment which: 1) is the result of a computational error on the return or on its supporting schedules or the result of a clerical error such as including receipts for periods other than that for which the return is intended, failing to take allowable deductions, or using an incorrect tax rate; and 2)

is made after the taxpayer has been notified in writing by the Board of the same or similar errors on one or more previous returns.

(C) Waiver of Interest as Condition of Deferring Action on Claim. If any person who has filed a claim for refund requests the board to defer action on the claim, the board, as a condition to deferring action, may require the claimant to waive interest for the period during which the person requests the board to defer action.

(6) Improper Use of Resale Certificate. Interest applies to the taxes imposed upon any person who knowingly issues a resale certificate for personal gain or to evade the payment of taxes while not actively engaged in business as a seller. The interest is computed from the last day of the month following the quarterly period for which a return should have been filed and the amount of tax or any portion thereof should have been paid.

(7) Untimeliness Caused by Disaster. A person may be relieved of the interest imposed by Sections 6459, 6480.4, 6480.8, 6513, and 6591 of the Revenue and Taxation Code if the board finds that the person's failure to make a timely return or payment was occasioned by a disaster and was neither negligent nor willful. Such person shall file with the board a statement under penalty of perjury setting forth the facts upon which the claim for relief is based.

For purposes of this section "disaster" means fire, flood, storm, tidal wave, earthquake or similar public calamity, whether or not resulting from natural causes.

(c) Penalties.

(1) Late Payments Generally.

(A) Prepayments.

1. Any person required to make a prepayment who fails to make a prepayment before the last day of the monthly period following the quarterly period in which the prepayment became due and who files a timely return and payment for that quarterly period shall pay a penalty of 6 percent of the amount equal to 90 percent or 95 percent of the tax liability, as prescribed in Section 6471 of the Revenue and Taxation Code, for each of the periods during that quarterly period for which a required prepayment was not made.

2. If the failure to make a prepayment as described in (c)(1)(A)1 above is due to negligence or intentional disregard of the Sales and Use Tax Law or authorized regulations, the penalty shall be 10 percent instead of 6 percent.

3. Any person required to make a prepayment who fails to make a timely prepayment, but who makes such prepayment before the last day of the monthly period following the quarterly period in which the prepayment became due, shall pay a penalty of 6 percent of the amount of the prepayment.

4. If any part of a deficiency in prepayment is due to negligence or intentional disregard of the Sales and Use Tax Law or authorized regulations, a penalty of 10 percent of the deficiency shall be paid.

The penalties provided in subparagraphs 2 and 4 of this subsection shall not apply to amounts subject to the provisions of Sections 6484, 6485, 6511, 6514, and 6591 of the Revenue and Taxation Code (subparagraphs (c)(1)(B), (c)(2)(A) and (c)(2)(B) of this regulation).

5. A penalty of 25% shall apply to the amount of prepayment due but not paid by any distributor or broker of motor vehicle fuel who fails to make a timely remittance of the prepayment as required pursuant to Sections 6480.1 and 6480.3 of the Revenue and Taxation Code.

6. Operative January 1, 1992, a penalty of 10 percent shall apply to the amount of prepayment due but not paid by any producer, importer, or jobber of fuel as defined in Section 6480.10 of the Revenue and Taxation Code who fails to make a timely remittance of the prepayment as required pursuant to Sections 6480.16 and 6480.18 of the Revenue and Taxation Code. This penalty shall be 25 percent if the producer, importer, or jobber knowingly or intentionally fails to make a timely remittance.

(B) Other Late Payments. A penalty of 10 percent of the amount of all unpaid tax shall be added to any tax not paid in whole or in part within the time required by law.

(C) Vehicles, Vessels and Aircraft. A purchaser of a vehicle, vessel or aircraft who registers it outside this state for the purpose of evading the payment of sales or use taxes shall be liable for a penalty of 50 percent of any tax determined to be due on the sales price of the vehicle, vessel or aircraft.

(2) Late Return Forms Generally

(A) Any person who fails to file a return in accordance with the due date set forth in Section 6451 of the Revenue and Taxation Code or the due date established by the board in accordance with Section 6455 of the Revenue and Taxation Code, shall pay a penalty of 10 percent of the amount of taxes, exclusive of prepayments, with respect to the period for which the return is required.

(B) Any person remitting taxes by electronic funds transfer shall, on or before the due date of the remittance, file a return for the preceding reporting period in the form and manner prescribed by the board. Any person who fails to timely file the required return shall pay a penalty of 10 percent of the amount of taxes, exclusive of prepayments, with respect to the period for which the return is required.

(3) Determinations.

(A) Negligence or Intentional Disregard. A penalty of 10 percent of the amount of the tax specified in the determination shall be added to deficiency determinations if any part of the deficiency for which the determination is imposed is due to negligence or intentional disregard of the Sales and Use Tax Law or authorized regulations.

(B) Failure to Make Return. A penalty of 10 percent of the amount of tax specified in the determination shall be added to all determinations made on account of the failure of any person to make a return as required by law.

(C) Fraud or Intent to Evade. A penalty of 25 percent of the amount of the tax specified in a deficiency determination shall be added thereto if any part of the deficiency for which the determination is made is due to fraud or intent to evade the Sales and Use Tax Law or authorized regulations. In the case of a determination for failure to file a return, if such failure is due to fraud or an intent to evade the Sales and Use Tax Law or authorized regulations, a penalty of 25 percent of the amount required to be paid, exclusive of penalties, shall be added thereto in addition to the 10 percent penalty for failure to file a return.

A penalty of 50 percent applies to the taxes imposed upon any person who, for the purpose of evading the payment of taxes, knowingly fails to obtain a valid permit prior to the date in which the first tax return is due. The 50 percent penalty applies to the taxes determined to be due for the period during which the person engaged in business in this state as a seller without a valid permit and may be added in addition to the 10 percent penalty for failure to file a return. However, the 50 percent penalty shall not apply if the measure of tax liability over the period during which the person was engaged in business without a valid permit averaged \$1000 or less per month. Also, the 50 percent penalty shall not apply to the amount of taxes due on the sale or use of a vehicle, vessel, or aircraft, if the amount is subject to the penalty imposed by Section 6485.1 or 6514.1 of the Revenue and Taxation Code.

(D) Nonpayment of Determinations. A penalty of 10 percent of the amount of the tax specified in the determination shall be added to any determination not paid within the time required by law.

(4) Improper Use of Resale Certificate. A penalty of 10 percent applies to the taxes imposed upon any person who knowingly issues a resale certificate for personal gain or to evade the payment of taxes while not actively engaged in business as a seller.

The penalty is 10 percent of the amount of tax or \$500, whichever is greater, if the purchase is made for personal gain or to evade payment of taxes.

(5) Direct Payment Permits. Every holder of a direct payment permit who gives an exemption certificate to a retailer for the purpose of paying that retailer's tax liability directly to the board must make a proper allocation of that retailer's local sales and use tax liability and also its district transactions and use tax liability if applicable. Such allocation must be made to the cities, counties, city and county, redevelopment agencies, and district to which the taxes would have been allocated if they had been reported by that retailer. Allocations must be submitted to the board in conjunction with the direct payment permitholder's tax return on which the taxes are reported. If the local and district taxes are misallocated due to negligence or intentional disregard of the law, a penalty of 10 percent of the amount misallocated shall be imposed.

(6) Failure to Obtain Evidence that Operator of Catering Truck Holds Valid Seller's Permit. Any person making sales to an operator of a catering truck who has been required by the Board pursuant to Section 6074 of the Revenue and Taxation Code to obtain evidence that the operator is the holder of a valid seller's permit issued pursuant to Section 6067 of the Revenue and Taxation Code and who fails to comply with that requirement shall be liable for a penalty of five hundred dollars for each such failure to comply.

(7) Failure of Retail Florist to Obtain Permit. Any retail florist (including a mobile retail florist) who fails to obtain a seller's permit before engaging in or conducting business as a seller shall, in addition to

any other applicable penalty, pay a penalty of five hundred dollars (\$500). For purposes of this regulation, “mobile retail florist” means any retail florist who does not sell from a structure or retail shop, including, but not limited to, a florist who sells from a vehicle, pushcart, wagon, or other portable method, or who sells at a swap meet, flea market, or similar transient location. “Retail florist” does not include any flower or ornamental plant grower who sells his or her own products.

(8) Relief from Penalty for Reasonable Cause. If the board finds that a person’s failure to make a timely return, payment, or prepayment, or failure to comply with the provisions of Section 6074 of the Revenue and Taxation Code is due to reasonable cause and circumstances beyond the person’s control, and occurred notwithstanding the exercise of ordinary care and the absence of willful neglect, the person may be relieved of the penalty provided by Sections 6074, 6476, 6477, 6480.4, 6480.8, 6511, 6565, 6591, and 7051.2 of the Revenue and Taxation Code for such failure.

Any person seeking to be relieved of the penalty shall file with the board a statement under penalty of perjury setting forth the facts upon which the claim for relief is based. Section 6592 of the Revenue and Taxation Code, providing for the relief of certain penalties does not apply to the 10 percent penalty imposed for failure to make a timely prepayment under Section 6478 of the Revenue and Taxation Code.

History: Amended September 18, 1963.

Amended August 2, 1965, applicable on and after August 1, 1965.

Amended June 23, 1966, applicable as amended on and after July 1, 1966.

Amended November 7, 1967, applicable on and after November 8, 1967.

Amended October 8, 1968.

Amended and renumbered November 3, 1969, effective December 5, 1969.

Amended December 17, 1975, effective January 1, 1976. Changed 1/2% interest to 1% per month.

Amended June 25, 1981, effective November 1, 1981. Added references. In (a) added Section 6072, improper use of resale certificates and Section 6593, leases to the U.S. Government. Added (b)(5) improper use of resale certificate. Added (b)(6) untimeliness caused by natural disaster. Added (b)(7) leases to the U.S. Government. In (c)(2) added (E) improper use of resale certificate. In (c) added (4) leases to the U.S. Government.

Amended February 3, 1983, effective July 3, 1983. In subdivision (a), deleted reference to Section 6053 and added the last line. In subdivision (b)(1), deleted reference to the rate of interest and added second paragraph. In subdivision (b)(2), (3) and (4), deleted reference to rate of interest. In subdivision (b)(5), deleted reference to rate of interest and added last sentence. In subdivision (b)(6), deleted reference to “NATURAL” and added reference to relief from interest and definition of “disaster”.

Amended October 9, 1985, effective February 9, 1986. In Subdivision (a), added reference to Revenue and Taxation Code Sections 6291-6294, and 6591.5 under “Interest” with short explanation under “subject;” and Sections 6291-6292, 6985.1, and 6514.1 (intent to evade) under “Penalties” with short explanation under “subject.” In Subdivision (b)(4), obsolete language is stricken and subheadings are added. In Subdivision (b)(5), deleted language concerning when interest is computed in last sentence and added language beginning “last day of the month . . . “. In Subdivision (b)(7), deleted reference to interest with respect to leases to the United States Government. In Subdivision (c), deleted obsolete provisions and updated text to show when penalties

apply to prepayments and purchases of vehicles, vessels, or aircraft when registered outside the state for purpose of evading the payment of sales or use tax.

Amended August 20, 1987, effective November 15, 1987. In subdivision (a), added references to Sections 6073, 6074 and 7051.2. In subdivision (c)(2)(C), added second paragraph pertaining to 50% penalty for fraud. Added subdivision (c)(4) pertaining to the penalties associated with a direct payment permit holder's improper allocation of a retailer's local tax liability due to the direct payment permit holder's negligence or intentional disregard of the law. Added subdivision (c)(5) pertaining to the penalty associated with the failure to obtain evidence that an operator of a catering truck holds a valid seller's permit. In subdivision (c)(6), added Sections 6074 and 7051.2 to the list of penalty provisions for which the Board may grant relief for reasonable cause.

Amended July 27, 1988, effective November 11, 1988. In subdivision (a), added provisions that pertain to the interest and penalty provisions found in Revenue and Taxation Code Section 7153.5 (Chapter 1064, Statutes of 1987).

Amended August 26, 1992, effective January 20, 1993. Paragraph (a) updated the list of Sales and Use Tax Law sections prescribing interest and penalties. Paragraph (b)(1) added explanation of procedures for computing interest on overpayments and under payments. Paragraphs (b)(2) and (c)(1)(A)6 added explanation of application of interest and penalties to amounts due but not paid on sale of fuel as provided in Sections 6480.16, Revenue and Taxation Code.

Amended May 19, 1997, effective June 18, 1997. Added new subdivision (c)(6) to incorporate provisions of Chapter 1130, Statutes of 1996, and renumbered the following subdivision.

Amended September 2, 1998, effective October 2, 1998. In subdivision (a), added references to Sections 6479.3, 6591, and 7076.5. Added new subdivision (b)(1)(D) to incorporate provisions of Chapter 686, Statutes of 1997. Added subdivision (c)(2) to incorporate provisions of Chapter 1294, Statutes of 1992 and Chapter 1087, Statutes of 1996, and renumbered following subdivisions.

Amended March 18, 1999, effective April 17, 1999. Reference to Section 6479.3 added to subdivision (a) to correct clerical omission in previous amendment. Added cross references in subdivision (a) to Sections 6593.5 & 6964 and added subdivision (b)(1)(E) & (F) to incorporate provisions of Assembly Bill 821, Statutes 1998, Chapter 612. Clerical amendments made to un-numbered paragraph in subdivision (c)(1)(A)4. Phrase "of the Revenue and Taxation Code" added to section numbers throughout; references to "Sales and Use Tax Law" deleted from subdivisions (c)(6) and (c)(8).